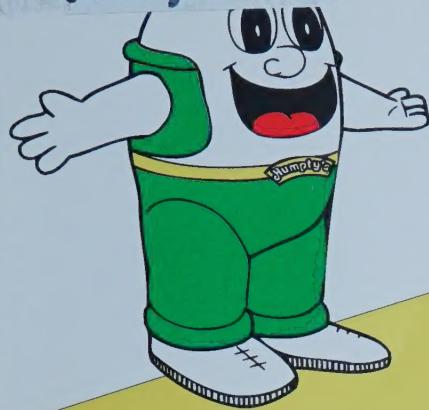


AR 71



Winspear Business Reference Room
University of Alberta
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Edmonton, Alberta T6G 2R6

Humpty's Restaurants International Inc.

1996
Annual
Report



Family Restaurants

Corporate Profile

Founded by Don and Jan Koenig in Calgary, Alberta, Canada, on November 17th 1977, Humpty's Egg Place grew into the ever popular and vastly successful Humpty's Family Restaurant chain of today.

In the beginning, the concept was simple – offer variety, quality, and tasty food in the virtually untapped breakfast market throughout all hours of operation. Even though breakfast was the original concept, the Humpty's menu of today has grown into an award winner, featuring extensive lunch and dinner selections; appetizers, soups, and desserts. The menu now provides the fullest spectrum of Breakfast, Lunch, and Dinner entrees for everyone young and old. For this important reason, the corporate identity was changed in 1988 from Humpty's Egg Place to Humpty's Family Restaurants, to better reflect its overall structure.

The enthusiastic public response to the first Humpty's location brought about the creation of a second location soon after. After a third location was opened in Calgary, franchise inquiries began to pour in from across North America. Potential franchisees were looking for an original concept with mass public appeal, and Humpty's was the answer. Consequently, Humpty's was given authorization to award franchises in 1982. Today, there are more than 40 Humpty's locations across Western Canada with planned expansion into Eastern Canada and the United States in the near

future. With the year 2000 approaching, intentions are to have over 100 locations in Canada and the United States.

Humpty's always has been, and will continue to be, successful because it delivers the three crucial elements of all great franchises: brand name recognition, operating systems, and ongoing support. The name Humpty's has come to mean great value with generous portions and reasonable prices. It also suggests outstanding service provided in a clean and pleasing environment. The Humpty's system employs numerous controls such as exclusive products, specially prepared items, and strict quality control procedures to give them the leading edge on the competition.

What it means, in the end, is that Humpty's provides continual field support and Head Office assistance to its franchisees. After all, the ultimate success of the Humpty's system depends on the success that its franchisees aspire to.



Letter to Shareholders

1996 Review

The fiscal results for the year ending December 1996 confirm the fourth consecutive year of significant improvement. The Corporation recorded a net income of \$578,148 in 1996 versus a net income of \$472,649 in 1995. This represents a very reputable increase of 22.3% from 1995 to 1996. You will note that the Corporation has presented its Statement of Income in a revised manner for 1996. Restaurant operations have been separated from Franchise revenue, therefore Shareholders can identify the income generated by the corporate locations. The Corporation results from 1995 to 1996 indicate a 23.2% improvement in Franchise revenue income and a 70.2% improvement in restaurant operations income.

Balance Sheet

The Corporation's balance sheet continues to illustrate financial health. The 1996 rates of current assets to current liabilities is 1.1:1 versus 1.65:1 in 1995. The Corporation is satisfied with this because the current liabilities includes long term debt of \$300,000 which will be paid in 1996 (Refer to the Sale-Leaseback Agreement in Note 4). Without this one time payment the ratio would be a respectable 1.86:1.

Of major relevance with the 1996 balance sheet is that current assets are up \$312,216 or 62.9%. The Corporation's total contingencies and commitments (short and long term debt) increased in 1996 by \$233,361 due mainly to the development of a Corporate location in Edmonton and the acquisition of a Franchise location.

The Corporation's equity position has improved \$453,448 over 1995 to \$754,796 and the Deficit line of \$350,010 will be in a positive position within the first two quarters of 1997.

Income Statement

Gross revenues (Franchise revenue and Restaurant operations sales) reflect a 43.2% (\$1,340,824) increase over 1995. Income before income taxes increased proportionally by 48.1% (\$227,499).

Cash Flow

The Corporation is extremely encouraged by the 1996 Statement of Changes in Cash Position. This statement indicates cash flow from operating activities increased a sizable 181.3% (\$520,618) from 1995.

1996 Activities

Improved same store sales of 8% over 1995 plus the addition of five new Franchise locations in 1996 contributed to the 25.4% increase in Royalty Fees. The new locations that were opened in 1996 and their anticipated sales volume based on current results:

January 1996	Red Deer, AB	\$960,000
March 1996	Nanton, AB	\$900,000
April 1996	Edmonton, AB (Corporate)	\$900,000
May 1996	Lloydminster, SK	\$1,100,000
June 1996	Brooks, AB	\$1,000,000
July 1996	Calgary, AB	\$1,100,000

Although the above locations do not have average sales as high as the locations opened in 1995 they still meet our criteria of average sales near \$1 million annually.

In February 1996 our Franchise Agreement with our Victoria location was terminated. The Franchisee at this particular location felt it would be more advantageous for them to operate as a



non-franchised location. Because this had been a troublesome location for the past two years the Corporation also felt it would be a benefit to all parties to sever the Franchise relationship. The Corporation was removed from its Head Lease obligations and therefore does not have any liability remaining in this location.

The Corporation continues to strive to have a strong working relationship with its Franchisees. Abuse of the system will not be tolerated, however, as the Corporation expands there will always be the possibility of Franchisor/Franchisee conflicts. The Corporation continues to adhere to the policy that if problems cannot be amicably solved then the Franchise relationship must be severed. The Corporation feels it has a strong group of operating Franchisees and would not hesitate to give the complete Franchise roster to a potential Franchisee to make reference checks.

1997 Program

The Corporation is extremely optimistic that 1997 will continue the momentum of achieving improvements in all segments of the business. Because the Corporation no longer has the luxury to utilize some previous losses for tax purposes it will have to concentrate on the top line (sales) to improve net income in 1997. Since Revenue Canada takes 45% of every \$1.00 of income before taxes the Corporation will have to generate \$1,051,178 income just to achieve the same net income as 1996.

To achieve improvements in net income in 1997 the Corporation will do the following:

1) New Locations Confirmed For 1997 *Projected Annual Revenue*

Camrose, AB	
Opened February 1997	\$ 1.1 M
Taber, AB	
Opened March 1997	\$ 900,000
Lethbridge, AB (Corporate)	
Opened April 1997	\$ 1.1 M

Fort Saskatchewan, AB	
Opening June 1997	\$ 1.1 M
Surrey, BC	
Opening October 1997	\$ 1.3 M
Prince George, BC	
Opening November 1997	\$ 1.5 M

Besides the above that are signed for 1997 the Corporation is negotiating with twelve other locations in Western Canada. There is a possibility that as many as six of these twelve locations could still go ahead in 1997.

2) *General and Administrative Expenses*

It is anticipated that a total of \$100,000 can be saved in the following areas

- Interest on Long Term Debt
- Professional Fees
- Loss on Head Lease settlements
- Bad Debts

3) *Same Store Sales*

It is expected that same store sales will again increase in 1997. This amount is projected at 8% and would mean an extra \$103,000 in Royalty revenues.

The Corporation continues to cautiously pursue and examine all acquisition opportunities. In 1996 two opportunities were examined then dismissed due to the incompatibility of the two systems. In the past the Corporation has only pursued similar Family Restaurant chains. As stated above ***all*** acquisition opportunities will be examined. The only two stipulations will be that they are food related and they don't compete directly with the Humpty's System. Because the Corporation is registering its trademark in the U.S. in anticipation of future growth it will also look at potential U.S. systems to bring to CANADA. In that situation the Corporation would establish a Development Agreement with the U.S. Corporation to develop its system in CANADA and vice versa the U.S.



Corporation to develop the Humpty's System in the U.S. Besides the acquisition opportunities the Corporation is also doing serious research into establishing a new Franchise Food System which would commence operations with twelve locations in Calgary. A similar system already operates very successfully in another North American city and research shows that it would function quite successfully in any centre over 40,000 population. It meets the criteria of non-competition with Humpty's. In fact the System could share the same real estate as Humpty's locations.

As stated above, the Corporation has identified three methods of expansion besides the ongoing development of the Humpty's Family Restaurant locations. They are:

- (a) Acquisition of other concepts
- (b) Development in CANADA of a U.S. System and vice versa in the U.S.
- (c) Establishing another System

Over the next twelve months the Corporation is quite confident that either (a), (b) or (c) will occur. It must be stressed however, that the Corporation is committed to controlled growth, therefore, only one method of expansion would be pursued. In other words the Corporation would not undertake an acquisition and the development of a new system simultaneously.

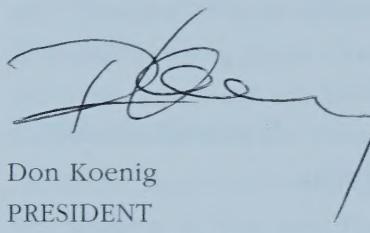
Shareholders will be kept informed of the Corporation's expansion plans via the Quarterly Report. Humpty's Restaurants International Inc. can now also be visited at its web page.

www.humptys.com

The Corporation sincerely appreciates the loyal patronage of its customers, the conscientious efforts of its staff and the continued support of its Shareholders. With the 1996 financial results being the best in the Corporation's history it continues to be well positioned for profitable growth in 1997 and beyond.

"Let The Tradition Continue"

Yours truly,
HUMPTY'S RESTAURANTS INTERNATIONAL INC.


Don Koenig
PRESIDENT

*Any inquires regarding the Auditor's Report and Consolidated Financial Statements should be directed to:

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Kenway Mack Slusarchuk Stewart
Chartered Accountants
#220, 333 - 11 Avenue S.W.
Calgary, AB T2R 1L9
Phone (403) 233-7750
Fax (403) 266-5267
OR
Don Koenig - President
Tom Scappatura - Controller

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2505 Macleod Trail S.
Calgary, AB T2G 5J4
Phone (403) 269-4675
Fax (403) 266-1973



Auditors' Report



**KENWAY
MACK
SLUSARCHUK
STEWART**

Chartered Accountants

To the Shareholders of Humpty's Restaurants International Inc.:

We have audited the balance sheet of Humpty's Restaurants International Inc. as at December 31, 1996 and 1995 and the statements of income, deficit and changes in cash position for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 1996 and 1995 and the results of its operations and the changes in its cash position for the years then ended in accordance with generally accepted accounting principles.

A handwritten signature in black ink that reads "Kenway, Mack, Slusarchuk, and Stewart".

March 14, 1997



Balance Sheet

As at December 31

	Assets	
	1996	1995
Current assets:		
Cash	\$ 299,907	\$ 24,522
Accounts receivable	290,598	302,515
Inventory	79,282	34,120
Prepaid expenses and deposits	75,718	90,077
Notes receivable, current portion (Note 2)	62,943	44,998
	808,448	496,232
Notes receivable , net of current portion (Note 2)	103,603	76,976
Capital assets (Note 3):		
Cost	2,588,230	2,105,660
Less – Accumulated amortization	535,881	401,277
	2,052,349	1,704,383
	\$2,964,400	\$2,277,591
	Liabilities	
Current liabilities:		
Accounts payable	\$ 180,940	\$ 190,376
Income taxes payable	122,000	–
Long-term debt, current portion (Note 4)	432,472	110,706
	735,412	301,082
Long-term debt , net of current portion (Note 4)	1,474,192	1,675,161
	2,209,604	1,976,243
	Shareholders' Equity	
Share capital (Note 5)	1,104,806	1,220,806
Deficit	(350,010)	(919,458)
	754,796	301,348
	\$2,964,400	\$2,277,591

Approved by the Board:

Director.

Director.



Statement of Income

For the Year Ended December 31

	1996	1995
Franchise revenue:		
Royalties	\$1,291,480	\$1,030,250
Advertising participation fees	568,398	455,966
Franchise sales	105,000	115,000
Management fees, service fees, rebates and other	239,879	188,035
	2,204,757	1,789,251
General and administrative expenses:		
Advertising and promotion	669,499	453,295
Salaries and employee benefits	433,011	326,637
Interest on long-term debt	143,341	164,957
Professional fees	134,970	119,760
Loss on head lease settlements	91,512	74,761
Office and miscellaneous	64,290	66,516
Amortization	58,545	43,269
Bad debts	42,906	75,329
Licenses and taxes	30,504	32,756
Rent	25,970	21,704
Interest and bank charges	19,220	24,175
	1,713,768	1,403,159
Income before the following	490,989	386,092
Restaurant operations:		
Sales	2,242,896	1,317,578
Cost of sales	734,272	437,143
Gross margin	1,508,624	880,435
Operating costs	1,149,223	665,968
Interest on long-term debt	72,834	80,452
Amortization	77,408	47,458
	209,159	86,557
Income before income taxes	700,148	472,649
Income taxes:		
Current	307,000	190,000
Utilization of losses not previously recognized	(185,000)	(190,000)
	122,000	-
Net income	\$ 578,148	\$ 472,649



Statement of Deficit

For the Year Ended December 31

	1996	1995
Deficit, beginning of year	\$ (919,458)	\$ (1,152,076)
Net income	578,148	472,649
Dividends	(8,700)	(17,450)
Related party transaction adjustment (Note 9)	–	(222,581)
Deficit, end of year	\$ (350,010)	(919,458)

Statement of Changes in Cash Position

For the Year Ended December 31

	1996	1995
Operating activities:		
Net income	\$ 578,148	\$ 472,649
Item not involving cash		
Amortization	135,953	90,727
	714,101	563,376
Changes in non-cash working capital balances	93,678	(276,215)
	807,779	287,161
Financing activities:		
Proceeds from long-term debt	321,305	–
Repayments of long-term debt	(200,508)	(164,554)
Redemption of preferred shares	(116,000)	–
Dividends	(8,700)	(17,450)
Proceeds on sale of share capital	–	108,000
	(3,903)	(74,004)
Investing activities:		
Purchases of capital assets	(483,919)	(71,712)
Notes receivable	(44,572)	131,122
Proceeds on disposal of capital assets	–	18,390
Acquisition of Humpty's Egg Place Ltd. (Note 9)	–	(222,581)
	(528,491)	(144,781)
Increase in cash	275,385	68,376
Cash (bank indebtedness), beginning of year	24,522	(43,854)
Cash, end of year	\$ 299,907	\$ 24,522



Notes to the Financial Statements

December 31, 1996 and 1995

1. Significant Accounting Policies

Consolidation

During 1996, the company wound up all its wholly owned subsidiaries into Humpty's Restaurants International Inc..

Inventory

The inventory is valued at the lower of cost and net realizable value.

Amortization

Capital assets are amortized using the declining balance method at the following rates:

Building	—	4%
Furniture and fixtures	—	20%
Equipment	—	20%
Automotive	—	35%
Leasehold improvements	—	Straight line over term of lease

Revenue Recognition

Revenue from franchise sales is recognized when all material conditions relating to the sale have been substantially performed.

2. Notes Receivable

	1996	1995
The notes receivable are unsecured and repayable in equal monthly instalments totalling \$6,073 including interest at rates of 0% to 12%	\$ 166,546	\$ 121,974
Less - Current portion	62,943	44,998
	<u>\$ 103,603</u>	<u>\$ 76,976</u>

3. Capital Assets

	1996	1995		
	Cost	Accumulated Amortization	Cost	Accumulated Amortization
Land	\$ 505,000	\$ —	\$ 505,000	\$ —
Building	1,353,361	261,546	1,247,121	222,126
Furniture and fixtures	287,779	142,987	210,516	103,694
Equipment	226,330	87,045	96,581	52,168
Automotive	44,292	29,730	46,442	23,289
Leasehold Improvements	171,468	14,573	—	—
	<u>\$ 2,588,230</u>	<u>\$ 535,881</u>	<u>\$ 2,105,660</u>	<u>\$ 401,277</u>



4. Long-Term Debt

	1996	1995
Mortgages		
Repayable at \$7,850 per month including interest at 11%, due December, 2001, secured by land and building.	\$ 700,000	\$ 691,790
Repayable at \$5,000 per month, interest only at 12%, secured by land and building.	500,000	500,000
Repayable at \$2,793 per month including interest at 18%, due September, 1999, secured by land and building.	72,312	90,961
Repayable at \$733 per month.	-	77,431
Sale-Leaseback Agreement		
Repayable at \$6,250 per month, interest only at 25%, due December, 1997, secured by certain equipment.	300,000	300,000
Loans Payable		
Repayable at \$3,333 per month plus interest at the bank's prime lending rate plus 1.75%, due May, 2001. Secured by chattel mortgages on equipment and leasehold improvements.	176,669	-
Repayable at \$1,842 per month plus interest at the bank's prime lending rate plus 3%, due October, 1999. Secured by a general security agreement.	62,611	-
Repayable at \$1,398 per month including interest 8%, due August, 2000. Secured by leasehold improvements.	53,266	65,325
Repayable at \$4,405 per month.	-	17,544
Notes Payable		
Repayable at \$1,253 per month including interest at 0% to 10%, due between March, 1997 and June, 1999.	31,126	29,000
Finance Contracts		
Repayable at \$292 per month including interest at 9.75%, due October, 1998, secured by certain equipment.	10,680	13,816
Less - Current portion	1,906,664	1,785,867
	432,472	110,706
	\$ 1,474,192	\$ 1,675,161

The principal repayments required are as follows:

1997	\$ 432,472
1998	145,101
1999	128,147
2000	78,249
2001	622,695
Thereafter	500,000
	\$ 1,906,664



5. Share Capital

Authorized -

- Unlimited number of common voting shares
- Unlimited number of first preferred shares, issuable in series.
- 12,000 8% cumulative, redeemable, retractable, convertible first preferred shares, series A.
- 12,000 10% cumulative, redeemable, retractable, convertible first preferred shares, series I.
- Convertible on the basis of fifty common shares for one preferred share.
- 714,285 10% cumulative, redeemable, retractable, convertible first preferred shares, series II.
- Convertible on the basis of one common share for one preferred share.
- Unlimited number of second preferred shares, issuable in series.

Issued -

	1996	1995
15,044,785 common shares (1995 - 15,044,785)	\$1,104,806	\$1,104,806
0 first preferred shares, series I (1995 - 4,640)	-	116,000
	\$1,104,806	\$1,220,806

Stock Option Plans

The following stock options were outstanding at December 31, 1996.

Number of Common Shares	Exercise Price	Expiry Date
200,000	\$ 0.14	October 17, 1999

6. Contingencies and Commitments

- a) The Company has entered into contracts with each of its franchisees that require continuing performance on the part of the Company.
- b) The Company is contingently liable under head lease agreements with the landlords of most of its franchisees. The likelihood or amount of any liability under these agreements cannot be reasonably determined. Any losses will be charged to income in the year incurred.

7. Net Income Per Share

Net income per share has been calculated using the weighted average number of shares outstanding during the year.

	1996	1995
Basic	\$ 0.038	\$ 0.033
Fully diluted	\$ 0.038	\$ 0.030

8. Lease Commitments

The Company has leases for the rental of premises, automobiles, and office equipment. The minimum annual lease payments for each of the next five years are as follows:

1997	89,349
1998	88,917
1999	87,653
2000	69,983
2001	46,280
	\$ 382,182



9. Acquisition of Humpty's Egg Place Ltd.

Effective July 31, 1995 the Company acquired 100% of the shares of Humpty's Egg Place Ltd. from a major shareholder. The companies were amalgamated immediately thereafter and these financial statements include the operations of the amalgamated company from August 1, 1995. The assets acquired were recorded at the book value in the financial statements of Humpty's Egg Place Ltd. The difference between the value of the common shares issued and the net liabilities assumed was charged to the deficit of the Company. Humpty's Egg Place Ltd. had income tax loss carry forwards of \$810,123 utilized to reduce taxable income of the amalgamated Company commencing August 1, 1995. The acquisition transaction is summarized as follows:

Book value of assets acquired	\$ 36,621
Less: liabilities assumed	159,202
Net liabilities assumed	122,581
Common shares issued	100,000
Related party transaction adjustment charged to deficit	\$ 222,581

10. Additional Franchise Information

	1996	1995
Number of restaurant locations in operation		
Franchises		
Beginning of year	33	31
New franchises sold	5	5
Franchises closed	(1)	(3)
End of year	37	33
Franchisor owned outlets	3	2
Total locations	40	35

11. Fair Value Disclosure

The fair value of all the Company's financial assets and liabilities approximates their carrying value, except for the sale-leaseback agreement which has a fair value of \$337,000 (1995 - \$369,000) and a carrying value of \$300,000 (1995 - \$300,000). The difference between fair value and carrying value results from changes in interest rates between the date that the sale-leaseback was issued and comparable interest rates at the year-end of the company.

12. Comparative Financial Statements

Certain figures in the 1995 financial statements have been reclassified to be consistent with the presentation used in 1996.



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